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Supreme Court, U.S.
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No. 95-1933

In The

Supreme Court of the United States

October Term, 1995

CHARLES ROGERS, *et al.*,

Petitioners,

vs.

WALTER ROGERS, *et al.*,

Respondents.

On Petition for Writ of Certiorari to the Supreme Court of Virginia

RESPONDENTS' BRIEF IN OPPOSITION

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32 pp

QUESTIONS PRESENTED

Whether personal property declared exempt at a certain value by operation of the United States bankruptcy law can be the subject of a subsequent state court fraudulent conveyance action filed by the same parties which failed to challenge the value or the exempt nature of such property in the United States Bankruptcy Court.

Whether the value of exempt property set by operation of the United States bankruptcy law can be challenged in a subsequent state court action by the same parties which did not challenge said value in the United States Bankruptcy Court.

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STATEMENT OF THE CASE

Prior to July 1, 1990, Respondents were creditors of Charles Rogers for a sum in the amount of $475,000 which arose from loaned and entrusted funds. These funds were never repaid and Respondents instituted legal proceedings in May of 1990 in an attempt to determine what had become of the funds. The legal proceedings were initiated in state court and alleged fraud and breach of fiduciary duty and requested an accounting. Soon after the initiation of the state court proceedings, on June 28, 1990, Charles Rogers filed a Chapter 7 bankruptcy petition and in the context thereof, listed his 100% interest in the closely held corporation, National Sportsman Association, Inc. ("NSA") as exempt for a value of $10.

Respondents filed two adversarial claims in the context of the Chapter 7 bankruptcy, one relating to the loss of the loaned funds and the other dealing with the loss of the entrusted funds. Among the grounds for the request of non-discharge in each of the adversarial actions was the allegation that the debtor had failed to adequately explain and account for the loss of the Respondents' $475,000 and had failed to meet the requirements of fiduciary duty with respect to the entrusted portion of the funds.

Charles Rogers was denied discharge of $145,000 of the debt upon a finding by the bankruptcy court that he had been entrusted with these funds and had unlawfully and wrongfully disposed of or converted said funds by co-mingling and failing to properly account for the entrusted funds. The Respondents then attempted to collect the judgment entered by the bankruptcy court and initiated the state court collection/fraudulent conveyance action which is the subject herein (the "State Court Action").

For at least fifteen years preceding the date of the Chapter 7 Bankruptcy filing, Charles Rogers owned all of the outstanding shares of stock in NSA. Unknown to any of the parties in interest during the bankruptcy, two days prior to her husband filing a petition in bankruptcy, Petitioner, Eleanor Rogers, opened a commercial checking account under the name of American Sportsman Association, Inc. ("ASA") using NSA's Federal Tax Identification Number. Four days later and two days after the filing of his Chapter 7 petition, on July 1, 1990, Charles Rogers transferred all of his ownership interest in NSA to his wife in exchange for $10 (the "Transfer").

It was established during the State Court Action that at the time of the Transfer, Eleanor Rogers knew her husband had filed a petition in bankruptcy, knew that he owed Respondents a substantial debt and knew that Respondents were demanding repayment of the debt.

Also unknown during the bankruptcy and established for the first time during the State Court Action, was the fact that on July 6, 1990, Eleanor Rogers deposited the first of over seven hundred NSA customer checks into the secret, ASA bank account. The deposit made on July 6, 1990 into ASA's account was comprised completely, of NSA gross receipts in the form of customer checks made payable to NSA. Petitioners now claim that on July 3, 1990 Eleanor Rogers transferred the bulk of NSA assets into ASA. (Petition for Writ, 5).

It was stipulated to during the State Court Action that for the six-month period following the Transfer, NSA customer checks were consistently and exclusively deposited into ASA's account. It was also undisputed that of the 726 total checks deposited into the ASA account from the date of the Transfer through September of 1993, 713 of them were payable to NSA.

The evidence presented in the State Court Action established that the activity in NSA's accounts immediately prior to and following the Transfer, decreased, such that NSA appeared to be worthless. It was established that immediately following the Petitioner's filing of the Chapter 7 bankruptcy action, the operations of NSA were simply being run through the books and records of ASA.

In this Court, Petitioners state, for the first time, that ASA was specially created for the purpose of receiving NSA assets. (Petition for Writ, p. 5). Ironically, the record will reflect that this is a fact the **Respondents** succeeded in establishing during the State Court Action and that the **Petitioners** adamantly denied throughout those proceedings. Petitioners claimed throughout the State Court Action that ASA was initially created for a separate and distinct purpose which had nothing to do with the operation of NSA. (State Court Trial Transcript, April 13, 1995, 128-131).

At the 11 U.S.C. § 341 Hearing of Creditors, the debtor was questioned with respect to the value stated for NSA on his bankruptcy schedules. The Petitioner contended that NSA was worthless because its liabilities exceeded its assets and the debtor was no longer capable of operating the business. Both Eleanor and Charles Rogers were questioned as to the value, books, records and business of NSA during discovery in the adversarial bankruptcy actions. (Bankruptcy Trial Transcript, June 6, 1991, 310-311; 339-340). The debtor and his wife, consistently stated that NSA had no value since its liabilities exceeded its assets and its assets had a value of less than $1000. A review of bank records of NSA indicated no receipts being received by the corporation and created the illusion that NSA had no ongoing business, thereby lending credence to the debtor's testimony.

In the State Court Action, it was proven that at the time of the Transfer, NSA had a valuable customer list capable of and in fact, generating a continuous stream of income. The trial court found that at the time of Transfer NSA had a substantial value, a value closer to the $294,000 figure alleged by Respondents than the $10 claimed by Petitioner.

Neither Charles nor Eleanor Rogers ever disclosed the existence or operation of ASA at the § 341 meeting of creditors. It was not disclosed during discovery in the adversarial actions or at the trial of the adversarial actions. Additionally, it was never disclosed at the time of the meeting of creditors that NSA was being operated under the name of, and through the books of ASA. None of ASA's books and records were ever produced or reviewed during the bankruptcy action. The Respondents only became aware of the existence and operation of ASA during discovery in the State Court Action.

It should be noted that the Respondents did not prevail on their conspiracy claim in the State Court Action *only* because of a finding by the trial court that Respondents had failed to prove damages with sufficient certitude relating to the conspiracy count. The trial court specifically found that the fraudulent conveyance of NSA and the use of ASA to receive NSA income was a product of Charles and Eleanor Rogers' shared intent to hinder, delay or defraud the creditors of Charles Rogers. Judge Hamblen Letter Opinion, May 3, 1995, *Rogers, et. al v. Rogers, et. al*, Chancery No. 33841, at 4.

The trial judge found as a matter of fact that ". . . [T]he manner in which funds belonging to NSA were transferred to the new corporation bespeak an intention on her [Eleanor Rogers] part to create yet another barrier between what she and her husband both obviously expected to be a continuing stream of income and his creditors." *Id.*

Additionally the trial judge felt compelled to comment on the credibility of Charles and Eleanor Rogers as a part of his factual findings. The trial judge stated that the Petitioners' testimony during the State Court Action was ". . . [C]learly designed to leave an impression of their intent and actions which is wholly at odds with what the bulk of the credible evidence establishes to have been reality." *Id.* at 2.

REASONS FOR DENYING THE WRIT

The Petitioners rely upon this Court's decision in *Taylor v. Freeland*, 503 U.S. 638 (1992) and the Eleventh Circuit's decision in *In re Green*, 31 F.3d 1098 (1994) in claiming that the state court's decision is contrary to decisions of this Court and applicable federal law. Petitioners err in their position that these decisions apply to the case at bar. Both *Taylor* and *In Re Green* are clearly distinguishable on the facts since neither case involved a conspiracy by the debtor to mislead and misrepresent the true value of the asset at the time of the claimed exemption.

In *Taylor* the trustee was afforded full and fair disclosure as to the potential value of the lawsuit claimed as exempt. It was clear to all parties involved in *Taylor* that the actual value of the lawsuit was unknown and there was no attempt to convince the trustee that the value of the asset was in truth the $1 stated on the bankruptcy schedule. Likewise, in *In re Green*, the trustee affirmatively conceded that he understood the $1.00 listing on the bankruptcy petition represented a contingent value for the asset and that he had not been misled into believing the lawsuit claimed as exempt had an actual present value of $1.00. *Id.* 1098.

Unlike *Taylor* and *In re Green*, this case presents facts in which the debtor together with his wife, both Petitioners herein, set about to purposefully mislead the creditors and trustee as to any potential value for the asset at issue. In the case at bar, the

Petitioners succeeded in convincing all parties in interest that the asset in question was worthless and they did so by hiding its value under the name of a new, undisclosed, corporate entity. It was established in the State Court Action that, unknown to any of the parties in interest and undisclosed by either the debtor or his wife when questioned under oath, NSA continued to do business and to process gross receipts under the name of ASA and through ASA's books and records.

Bankruptcy Rule 4003(b) operates as a very short statute of limitations against creditors challenging a claimed exemption and requires an objection to the property claimed as exempt within thirty days of the meeting of creditors. It has long been established that a cause of action for fraud does not accrue while the fraud is concealed. *Bailey v. Glover*, 21 Wall 342, 349-350, 22 L. Ed. 636 (1875); *Holmberg v. Armbrecht*, 327 U.S. 392, 397 (1946). This Court has consistently held that statutes of limitation are to be interpreted reasonably so as not to become an instrument which encourages and protects a fraudulent practice. *Id.* In *Bailey* this Court held that in cases of fraud there is an implied exception in a statute of limitations for a situation which involves a purposeful concealment which continues beyond the time the statute would bar action to undo the fraud. In *Holmberg* the Court went on to state that the exception recognized by this Court in *Bailey* is written into every federal statute of limitations. It was not this Court's intention that their decision in *Taylor* overrule the long-standing policy against allowing parties to use the law to perpetrate and protect them against a concealed fraud.

Taylor involved no fraud on behalf of the debtor and therefore is not applicable to the case at bar. The state court's decision in this matter is fully consistent with the law as expressed by this Court in *Bailey* and *Holmberg*. The state court's decision is consistent with the underlying policy of federal and state law not to allow a purposefully concealed fraud

to be protected by the arbitrary operation of a statute of limitations.

Even if *Taylor* applied to the facts at bar, which Respondents contend it does not, the state court's decision in this case does not serve to deny the debtor the claimed exemption. The decision only serves to allow the creditors to seek satisfaction of their judgment against that portion of the asset which was not claimed as exempt by the debtor.

As pointed out in *Addison v. Reavis*, 158 B.R. 53 (E.D. Va. 1993) *aff'd sub nom. Ainslie v. Grablowski*, 32 F. 3d 562 (4th Cir. 1994), Virginia has selected, pursuant to federal law, to opt out of the exemptions provided by the bankruptcy code and to allow debtors to claim only those exemptions enumerated under Virginia law. *See* 11 U.S.C. § 522 (b)(2)(A) and Va. Code Ann. § 34-3.1 (Mich. 1990). The debtor in the present case claimed the exemptions in question pursuant to homestead exemptions under Virginia law.

Virginia law does not confine the debtor to the specific amount listed for a particular exemption on his homestead deed but rather allows the debtor to amend upwards the valuation stated in the schedule. *In re Waltrip*, 360 F. Supp. 488 (E.D. Va. 1966). Virginia law allows debtors to state nominal values for assets and to adjust them upwards when the true value of the asset is determined. *Addison* at 57. By not objecting to property claimed as exempt in a bankruptcy schedule, the trustee and creditors only recognize that the debtor has a valid statutory basis for the claim and not that the debtor's valuation of the property at issue is conclusive. *Id.* at 61.

The question in the case at bar, as in *Addison*, is not whether the debtor is entitled to the exemption but rather what did the debtor actually exempt? In *Addison*, the court dealt with an

ownership interest in various partnerships. In the case at bar the asset at issue is similar, ownership in a closely held corporation. In both cases the assets at issue were divisible and the *Addison* court determined that in such cases, ambiguities in the debtors schedules as to how much of the divisible asset was being claimed as exempt must be construed against the debtors. *Id.* at 60.

In the case at bar, the ambiguity in the Petitioner's bankruptcy schedule arises from his claim of a $10 exemption in a divisible asset. He does not state that a specific number of shares of stock are claimed as exempt with a value of $10, he claims a $10 exemption in his 100% ownership. Appropriately construing the ambiguity against the debtor, it is clear that in this case, the debtor claimed as exempt $10 worth of his ownership interest, leaving the remainder of the asset available for creditors' claims.

The presence of a concealed fraud at the time of the claimed exemption arguably voids the entire exemption. However, assuming for the purpose of argument only, that the $10 exemption claimed on the debtor's bankruptcy schedule was available to the debtor pursuant to Virginia law, Respondents contend that Virginia law allows only exemptions up to a stated dollar amount and that the debtor has not successfully exempted any property beyond the statutory limit. Since the debtor chose not to amend his schedule to exempt any more of his ownership interest in the corporation beyond the $10 claimed on his bankruptcy schedule, he is not entitled to claim additional value beyond the statutory amount as exempt property.

Taylor was written in the context of a debtor who explicitly claimed as exempt the entire value of property worth an unknown amount of money. In this case, the debtor did not claim the entire amount of his interest in the corporation as exempt but

instead claimed a precise dollar amount of his interest exempt. The considerable amount of value remaining in the divisible asset, was never claimed as an exemption and remains available for the satisfaction of creditors' claims.

CONCLUSION

Respondents contend that *Taylor* is not applicable to the facts at bar because of the element of purposeful concealment by the debtor at the time of the claimed exemption. Since *Taylor* does not apply and is clearly distinguishable on the facts, the state court's decision is not inconsistent with decisions of this Court. On the contrary, the state court's decision is entirely consistent with the law and policy as expressed by this Court in *Bailey* and *Holmberg*. Since the state court decision is consistent with the law and policies expressed by this Court, there is no need for this Court to do further inquiry into this matter.

Even if the Court were of the opinion that *Taylor* controls the case at bar, the state court's decision is not contrary to the holding in *Taylor*. The state court's decision in this case does not operate to deny the debtor the exemption claimed. The decision merely disallows the debtor from claiming, as exempt, property which exceeds the statutory limit as set by Virginia law and which was not unambiguously stated as a claimed exemption on the debtor's schedules.

WHEREFORE, the Respondents respectfully request the Court deny the Petition for a Writ of Certiorari herein.

Respectfully submitted,

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APPENDIX A — EXCERPTS OF STATE COURT TRIAL TRANSCRIPT DATED APRIL 13, 1995; pp. 128-131

[Commencing at page 128]

to this attorney's questions and answer them directly.

THE WITNESS: Okay.

THE COURT: You have a tendency, pronounced, if I may say, not to do that. And it's prolonging this hearing.

THE WITNESS: Okay.

BY MR. WEBB:

Q My question was: When did you decide to start ASA?

A I think it was — I think it was like July, '90.

Q Why did you decide to start ASA?

A I — Well, first — I wanted two separate clubs.

Q Why?

A Because I wanted to have two separate clubs, because with the way that the NSA was constructed, I was doing so much work on the phones, and things like that, I wanted to take the ASA and divide it for small game hunters where they would pick four or five properties. And they wouldn't have to call in to me all the [129] time, see. And I could — The big game hunters could have another one. So, the small game hunters could have their privacy, and they wouldn't be running into each other and always complaining. So, that would be for the small game hunters.

Appendix A

THE COURT: Excuse me, ma'am.

(A brief discussion was held off the record.)

THE COURT: I'm sorry, Ms. Rogers. Go ahead. Would you repeat your question, please?

MR. WEBB: Yes, sir.

BY MR. WEBB:

Q The question was, Ms. Rogers — Let me start over again.

THE COURT: Why did you want to start the club?

BY MR. WEBB:

Q Why did you want to set up the separate club?

A Well, I wanted to set up the separate club because I wanted to make the small game hunters into one club. This would eliminate the [130] phone when you're working, you know, with a lot of members, because then the small game hunters wouldn't have to call in, like the deer hunters. So, they would get a cheaper rate, and they wouldn't be paying for my service, see. So, if I could divide the club into small game hunters and big hunters, that would help a lot.

Q Were you able to do that?

A I started it —

Appendix A

Q Answer first: Were you able to do that?

A No.

Q Why not?

A Because I just didn't have — I just didn't have the time.

Q What was taking up your time?

A What was taking up my time was basically dealing with my husband and his problems — a lot of his ups and downs — and then also handling the NSA members. I just didn't have time to, you know, construct it the way I wanted it to be.

Q Do you consider ASA to be a corporation [131] separate from NSA?

A Yes.

Q There came a time, as you're aware — You've heard testimony about checks being deposited made out to NSA and ASA bank accounts; do you remember that testimony?

A Yes.

Q You are aware that that happened; are you not?

A Yes.

Q Do you know why that occurred?

A Well —

Q And if you do, why did it occur?

A Well, what happened was I had put $5,000 in when I started ASA of my money from my charge card to start it. And I put the — I had both corporations. I owned both corporations; so, therefore, I had put it in there to start so I could get the stuff for like different membership badges, and different cards, and stationary, and things like that, and sort of help that one go along. But I've had so much commotion, I haven't got it all right yet, so —

* * *

APPENDIX B — EXCERPTS OF BANKRUPTCY TRIAL TRANSCRIPT DATED JUNE 6, 1991; pp. 310-311, 339

[Commencing at page 310]

INTO IT.

Q TURNING TO THE NATIONAL SPORTSMAN ASSOCIATION. DID YOU TRANSFER THE STOCK OF THAT CORPORATION TO YOUR WIFE AND SON?

A I SOLD IT TO THEM.

Q HOW MUCH DID YOU SELL IT THEM FOR?

A FOR $10.

Q WHEN DID YOU CONSUMMATE THE SALE?

Q ABOUT TWO DAYS AFTER YOU FILED BANKRUPTCY?

A ON OR ABOUT JUNE 30TH.

Q WHAT WAS YOUR RATIONALE FOR TRANSFERRING THE NSA OVER TO YOUR WIFE?

A THE RATIONALE WAS THAT I WAS IN NO POSITION AT THE TIME TO HELP ON IT OR WORK WITH IT. IT HAD A NEGATIVE NET WORTH. IT HAD UNEARNED INCOME THAT HAD TO HAVE BEEN COLLECTED AND IT WASN'T EARNED. IT HAD NO ASSETS. IT LEASES PROPERTIES, AND ALL THE LEASES ARE YEAR-TO-YEAR, AND IT RUNS GENERALLY JULY 1ST TO JUNE 30.

SO AT THAT TIME OF TRANSFER, THERE WAS A

Appendix B

NEGATIVE NET WORTH. THERE WAS NO — THERE WASN'T ANY TYPE OF BIG DEAL OR ANY TYPE OF ASSETS, SO TO SPEAK. IF SOMEBODY WOULD TAKE AND WORK WITH IT, IT HAS POTENTIAL, AND SHE HAS TAKEN IT UPON HERSELF TO WORK WITH THAT, ALONG WITH MY SON, MY TWO SONS, AND THEY'RE TRYING TO MAKE A GO OF IT.

[311] Q HAVE YOU FILED YOUR TAX RETURNS FOR NSA FOR THE FISCAL YEAR ENDING JUNE 30, 1990?

A NO, I HAVEN'T.

Q WHEN WERE THEY DUE?

A MARCH 15, 1991, I BELIEVE.

Q YOU GOT AN EXTENSION TO FILE THOSE; DID YOU NOT?

A I GOT AN EXTENSION, YES, SIR.

Q ON MARCH 15TH, THE DUE DATE FOR FILING THESE TAX RETURNS, DID YOU FILE THEM YET?

A NO, I DIDN'T. I HAVEN'T FILED THEM, YET.

Q WHAT'S YOUR STATUS WITH THE IRS THEN?

A WELL, THE CORPORATION IS NOT GOING TO OWE ANY INCOME TAX, BECAUSE, AS YOU KNOW, IT'S A SUB-CHAPTER S CORPORATION, AND IF YOU'RE

LATE, AND DON'T OWE ANY INCOME TAXES, IT'S REALLY NOT A BIG DEAL. I'VE BEEN WORKING ON THIS, YOU KNOW, SINCE I GUESS BACK IN JUNE OF '90, ESPECIALLY SINCE NOVEMBER OF '90. I HAVEN'T HAD TIME TO DO ANYTHING ELSE.

Q ARE YOU IN DEFAULT THEN WITH THE IRS?

A NO.

MR. WEBB: OBJECT AS TO THE RELEVANCE OF THIS.

THE COURT: SUSTAINED.

MR. ROBERTS: YOUR HONOR, I JUST THINK IT GOES TO HIS BOOKKEPING AND RECORD KEEPING, AND WHETHER HE CAN EXPLAIN — WE ASKED FOR THOSE RECORDS FOR NSA, SO WE COULD

* * *

[Commencng at page 339]

A YES.

Q WAS IT STILL ACTIVELY ENGAGED IN THE BUSINESS OF PROVIDING HUNTING LAND FOR PEOPLE?

A YES, IT'S AN ALL-YEAR PROGRAM.

Q HOW WOULD YOU DESCRIBE THE PROFITABILITY OF NSA IN JUNE OF 1990?

Appendix B

A JUNE OF 1990, THERE WAS NOTHING LEFT. I STARTED WITH JUST LIKE A BLANK. I STARTED THE WHOLE NEW YEAR WITH NOTHING.

Q DID THE CORPORATION NOT HAVE ANY ASSETS, TO SPEAK OF, AT THE TIME THAT YOU TOOK IT OVER?

A NO, WE LEASED ALL THE LAND.

Q WAS THERE ANY CASH IN THE BANK?

A NO CASH IN THE BANK THAT I KNOW OF, BECAUSE HE WAS GOING TO CLOSE IT OUT. DARREN IS HANDLING THE NSA FINANCES. HE'S A CPA, MY SON, AND I'M JUST WORKING IT.

Q SO THERE WAS NO CASH WHEN YOU TOOK THE CORPORATION OVER?

A NO. I STARTED — WELL, NOT TO MY KNOWLEDGE, BECAUSE I SAID I WOULD START IT NEW, SO I JUST STARTED IT IN THE NEW YEAR. THE RENEWAL STARTED IN JULY.

* * *